

VZCZCXRO7544
RR RUEHLH RUEHPW
DE RUEHIL #3763/01 3381352
ZNR UUUUU ZZH
R 031352Z DEC 08
FM AMEMBASSY ISLAMABAD
TO RUEHC/SECSTATE WASHDC 0504
INFO RUEHRC/DEPT OF AGRICULTURE WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RHEBAAA/DEPT OF ENERGY WASHDC
RUEHRC/USDA FAS WASHDC 4288
RUCPDOG/DEPT OF COMMERCE WASHINGTON DC
RUMICEA/USCENTCOM INTEL CEN MACDILL AFB FL
RHMFISS/CDR USCENTCOM MACDILL AFB FL
RUEKJCS/SECDEF WASHINGTON DC
RUEHKP/AMCONSUL KARACHI 0725
RUEHLH/AMCONSUL LAHORE 6456
RUEHPW/AMCONSUL PESHAWAR 5315
RUEHNE/AMEMBASSY NEW DELHI 4131
RUEHBUL/AMEMBASSY KABUL 9507
RUEHKT/AMEMBASSY KATHMANDU 9320

UNCLAS SECTION 01 OF 03 ISLAMABAD 003763

SENSITIVE
SIPDIS

REF: A. ISLAMABAD 03699 B. ISLAMABAD 03560

E.O. 12958: N/A

TAGS: [ECON](#) [ETRD](#) [EAID](#) [EFIN](#) [EINV](#) [PK](#)

SUBJECT: STAKEHOLDER REACTIONS TO THE IMF PROGRAM

11. (SBU) SUMMARY. All stakeholders surveyed agree that Pakistan's Stand-by Agreement (SBA) with the International Monetary Fund (IMF) was inevitable and will provide much needed economic stability in the short-term. The SBA document is not yet fully public so stakeholders are reacting to interest rate increases, the rupee exchange rate, and the fiscal deficit. The IMF's Resident Representative clarified on November 28 that the SBA does not have specific requirements for how government revenues should be increased beyond improving the effectiveness of income tax collection, but stakeholders are worried about possible increases in tax coverage of the agricultural income, real-estate profits, and other capital gains.

12. (SBU) SUMMARY CONTINUED. The reactions in the financial markets are broadly positive but have only halted Pakistan's economic downward spiral rather than markedly improving indicators. The business community has a generally favorable opinion of the IMF program because they expect it will impose fiscal discipline on the government, catalyze taxation reform and improve investor confidence. They are concerned however, that higher interest rates and import costs will reduce competitiveness. A spokesman of the opposition party Pakistan Muslim League (PML-N) said that the SBA will only be successful if it has a broad perspective and revives the economy but otherwise he thinks that Pakistan will remain an IMF program recidivist. END SUMMARY.

13. (SBU) Post has surveyed a variety of contacts from various fields to assess the local reaction to Pakistan's acceptance of an SBA with the IMF. While the full details of the program have yet to be posted publicly on the State Bank website, information has been steadily printed in local media and numerous talk show programs have hosted question and answer programs related to the IMF program. While opinions vary, most commentators accept that under the current economic conditions, Pakistan's government had no other option than to seek IMF assistance.

MARKETS

14. (SBU) The reactions in the financial markets are broadly positive but have only halted Pakistan's economic downward spiral rather than markedly improving sentiments. The Pakistan rupee exchange rate appreciated from 80.8 rupees to the dollar at the beginning of

November to 78.6 rupees on November 24, when the GOP officially requested the SBA. Ratings agencies continue to hold Pakistan's debt ratings on review for further downgrades. Foreign reserves stand at USD 5.98 billion as of December 2.

¶15. (SBU) The Karachi Stock Exchange, by far the largest stock exchange in Pakistan, had a "floor" placed to halt rapidly declining stock values on August 28 which remains in place. Local analysts expect that about USD 1 billion of the USD 2.2 billion foreign portfolio investors have in the stock market will exit once the floor is removed. The IMF and GOP remain in consultation on how best to remove the floor, with no date set. Trading off the market remains at a 30 percent discount to the artificial values despite the SBA. Foreign investors made net withdrawals of portfolio investments in Pakistan of USD 26.4 million during November and USD 278.4 million since July. (reftel B)

¶16. (SBU) Sakib Sherani, Chief Economist for Pakistan at the Royal Bank of Scotland and member of the Economic Advisory Committee for the Government of Pakistan (GOP), said that the delay in approaching the IMF and GOP policy inaction have damaged Pakistan's economy and investor confidence. He believes the IMF program will improve investor confidence and unblock assistance from the World Bank and the Asian Development Bank (ADB).

¶17. (SBU) Sherani projected that even after the SBA, Pakistan still has an external financing gap of around USD 2 billion. He assumes the current account deficit will be USD 8.5 billion, portfolio outflows from the stock market of USD 1.5 billion, debt servicing of USD 2.5 billion putting the total financing need at USD 12.5

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billion. He projected this total financing need will be partially offset by foreign direct investment of USD 3 billion this year; loan disbursements from the IMF of USD 4.5 billion; funds from the World Bank and the ADB of USD 1 billion each; and assistance from the Islamic Development Bank, the UK's Department for International Development, and other bilateral sources of USD 1 billion.

INDUSTRIALISTS

¶18. (SBU) According to Majyed Aziz, a leading industrialist and former president of the Karachi Chamber of Commerce and Industry (KCCI), the business community has a generally favorable opinion of the IMF program because they expect it will: (1) impose fiscal discipline and narrow the budget deficit, (2) reassure the multilateral institutions, releasing World Bank and ADB projects, (3) promote documentation of the informal economy, (4) catalyze taxation of the agricultural sector and real-estate, and (5) improve investor confidence and FDI inflows (if the law and order situation improves).

¶19. (SBU) Anis-ul-Haq, the Director of the All Pakistan Textile Mills Association (APTMA), said that he was assured by de facto Finance Minister Shaukat Tareen that the IMF conditionality is not harsh. Haq expects that the IMF program will reduce inflation and stabilize the exchange rate. Haq said that rupee stability helps the textile industry by increasing predictability of domestic and imported cotton prices.

¶110. (SBU) Anticipating that the SBA will address exchange rate flexibility, Aziz and Haq emphasized that Pakistani production heavily relies on imports. Aziz also pointed out that while global prices have declined, some producer costs are still high because contract commitments add a lag to price and policy changes, adding additional pressure on producer costs. Aziz estimates that 30 to 35 percent of all inputs are imported, so a depreciating rupee has mixed effects on the costs of production and competitiveness. Aziz thinks that if the exchange rate remains around 78 rupees to the dollar then producers will have the necessary "breathing space." Haq said APTMA expects the rupee will appreciate to 75 per dollar.

¶111. (SBU) A prior condition of the IMF program was to increase the policy rate from 13 percent to 15 percent. Aziz says lending rates

are high, around 20 percent for the average customer. Haq said that the textile association is very concerned by interest rate increases because members borrowed money from banks at 5 to 6 percent for capital improvements but will have to repay at 17 percent to 18 percent. APTMA has taken up this issue with the government and is demanding compensation from the government for interest rate hike. COMMENT: Consumer price inflation in FY '08-'09 is 23 percent, so while rates are higher they remain negative in real terms. END COMMENT.

¶12. (SBU) Aziz believes that IMF funds will not have an immediate affect on the rupee economy, but the program will likely decrease inflationary pressure and remove subsidies on food and fuel. Aziz, however, feared that a rise in gas and electricity prices will negatively impact the poor. Aziz also fears that the current government might not successfully implement the IMF program. He said, "This government backtracks in hours and may not be able to handle [IMF] conditionalities."

PARLIAMENT

¶13. (SBU) As a member of the most influential opposition party, Ahsan Iqbal, Chief Coordinator & Information Secretary of the Pakistan Muslim League (PML-N), criticized the SBA. He emphasized that the IMF loan must be repaid with interest so it has to be applied to productive uses. Iqbal said the policy rate hike will result in stagflation by making it difficult for businessmen to finance even their working capital needs. He said that an

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agriculture tax is not a good idea because it will not yield significant revenue but will have very adverse political ramifications. Iqbal was also critical of devaluation, saying "devaluation never helps" Pakistan because of its heavy reliance on imports.

¶14. (SBU) Iqbal said that the IMF program will only be successful if it has a broad perspective and its goal is to revive the economy. Otherwise Pakistan will keep moving from one IMF program to another. "The GOP should rationalize its own interests," rather than just following the instructions of the IMF. He continued, "The IMF's agenda is to get its money back. We need to understand our own agenda."

¶15. (SBU) COMMENT. While many details have been openly discussed on local media, stakeholders can only speculate on policy implications until the SBA requirements are fully public. The first tranche of USD 3.1 billion is already on deposit at the State Bank of Pakistan and seems to be providing additional comfort that the GOP will meet current payment obligations. Post will continue to closely monitor implementation of the SBA and report accordingly. END COMMENT.

PATTERSON